Balanced Scorecard – Overview

Purpose:
The *Balanced Scorecard (BSC)* is a strategic performance management tool that translates a company's strategic plan into actionable objectives and measurable performance indicators. It helps ensure that daily operations align with long-term goals.

Background

- Developed by **Dr. Robert Kaplan** and **Dr. David Norton** (Harvard Business Review, 1992).
- Originally created to overcome the limitations of relying solely on **financial performance** to evaluate managers.
- It has evolved from a **performance measurement system** into a **strategic management framework**.

Key Idea

Managers often focus too heavily on **short-term financial results** (e.g., quarterly profits).
This can harm **long-term success**, such as by cutting costs in ways that reduce quality and customer satisfaction.

The Balanced Scorecard addresses this by combining:

- **Financial measures** (lagging indicators of past performance)
- **Non-financial measures** (leading indicators of future success)

Main Benefits

1. Links **strategy to operations** — turns strategic plans into day-to-day "marching orders."
2. Promotes **goal congruence** — aligns division and individual objectives with corporate goals.
3. Balances **short-term and long-term** performance evaluation.
4. Encourages focus on **future growth and sustainability**, not just immediate profits.

Financial vs. Non-Financial Measures

Type	Description	Indicator Type	Examples
Financial	Measures results of past actions	Lagging	ROI, revenue growth, profit margin
Non-Financial	Measures activities that drive future results	Leading	Customer satisfaction, quality improvements, innovation rates

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Strategic Linkage

- Each organization develops its own **unique scorecard** based on its **vision, mission, and strategy**.
- Divisional and individual scorecards must align with the **overall corporate strategy**.
- Promotes organization-wide alignment and cooperation toward common objectives.

Balanced Scorecard – Four Perspectives

The **Balanced Scorecard (BSC)** translates a company's **vision and strategy** into a set of performance objectives and measures, viewed from **four interrelated perspectives**.
These perspectives are **hierarchical**, meaning:

Learning & Growth → Internal Processes → Customer → Financial
Each lower-level perspective drives success in the one above it.

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1. Financial Perspective

Focus: How do we look to our shareholders?
Objective: Measure financial success and create shareholder value.
Typical Metrics:

- Operating income / Net profit
- Revenue growth (especially from new products)
- Gross margin %
- Cost reduction percentages
- Residual Income (RI)
- Return on Investment (ROI)

Key Point:
Financial performance is critical, but **long-term financial success** depends on achieving goals in the other perspectives (customer, internal process, learning & growth).

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2. Customer Perspective

Focus: How do customers see us?
Objective: Measure success in target market segments and customer satisfaction.
Typical Metrics:

- Market share and market growth in target segments
- Customer satisfaction index / survey scores
- Number of repeat customers
- On-time delivery %
- Product return rate / defect rate
- Product reliability and service quality

Examples of Strategic Goals:

- Become the **lowest-cost supplier** → measured by total cost to customer
- Be known for **high quality** → measured by product defects or reliability
- **Superior service** → measured by response time and post-sale service quality

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3. Internal Process Perspective

Focus: What must we excel at internally?
Objective: Identify and measure the internal operations and innovations that create value for customers.
Typical Metrics:

- Production efficiency (e.g., unit cost, cycle time, plant utilization)
- Number of new product introductions (innovation)
- Percentage of processes using advanced controls (technology level)
- Employee service efficiency (e.g., time to resolve customer inquiries)

Example Links:

- To be the *lowest-cost supplier* → need efficient, low-cost production.
- To achieve *high quality* → need strong internal manufacturing and quality control processes.
- To *meet customer needs better than competitors* → need innovation and effective service systems.

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4. Organizational Capacity / Learning and Growth Perspective

Focus: How can we continue to improve and create value?
Objective: Build the foundation (people, systems, and culture) needed for long-term success.
Components:

- **Human Capital** – Employee skills, training, and knowledge
- **Information Capital** – Systems, databases, and technology infrastructure
- **Organizational Capital** – Culture, leadership, teamwork, and knowledge sharing

Key Idea:
Strong learning and organizational capacity support effective internal processes, which in turn enhance customer satisfaction and lead to better financial performance.

Hierarchy of the Balanced Scorecard

Financial Perspective

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Customer Perspective

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Internal Process Perspective

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Organizational Capacity / Learning & Growth Perspective

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Vision and Strategy

Critical Success Factors (CSFs) and Key Performance Indicators (KPIs)

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1. Purpose and Link to the Balanced Scorecard

- The **Balanced Scorecard (BSC)** translates strategy into measurable objectives.
- To do this effectively, organizations must identify **Critical Success Factors (CSFs)** and track them using **Key Performance Indicators (KPIs)**.
- **CSFs** → what must be done well.
- **KPIs** → how success in those areas is measured.

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2. Critical Success Factors (CSFs)

Definition:
Specific activities or areas that are **vital for achieving organizational goals and maintaining competitive advantage**.

Key points:

- CSFs directly affect efficiency, effectiveness, and long-term viability.
- They vary by industry, company, and strategy.
- Only a **few** CSFs should be chosen — the ones most essential to strategic success.

Example:
In an industry with **rapid technological change**, **Research and Development (R&D)** is a **critical success factor**.

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3. Key Performance Indicators (KPIs)

Definition:
Quantifiable measures that evaluate how effectively the organization is performing in its **critical success factors**.

Purpose:

- Track progress on strategic priorities.
- Provide focus for management attention and performance improvement.
- Serve as the measurement foundation of each **Balanced Scorecard perspective**.

Examples (based on strategy):

Strategy Focus	CSF	Typical KPI
Customer Service Excellence	Fast, helpful support	Average telephone wait time, % of issues resolved on first contact
Product Leadership	R&D innovation	Number of new product launches, % of revenue from new products
Operational Efficiency	Cost control	Unit cost, production cycle time, % of waste reduction
Quality Leadership	Product reliability	Defect rate, warranty claims, customer satisfaction score

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4. Example: Customer Service–Driven Organization

A 3D printing services company relies on excellent customer service:

- **CSFs:**
    - Skilled, knowledgeable customer service personnel
    - Fast response time (minimal wait time)
    - Access to accurate technical information
- **KPIs:**
    - Average customer wait time on calls
    - Customer satisfaction rating
    - % of service reps trained on new technology
    - System uptime for customer information database

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5. Key Takeaways

- CSFs = *what must be done well to succeed*
- KPIs = *how performance is measured in those areas*
- Both must be **aligned with strategy** and **few in number** (focus on quality, not quantity).
- Together, they make the **Balanced Scorecard actionable and strategy-driven**.

Strategy Map – Overview

A **Strategy Map** visually shows how an organization's **strategic objectives** in the four Balanced Scorecard perspectives are **linked together in cause-and-effect relationships**.
It translates **vision and strategy** into specific, interconnected goals.

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1. Purpose of a Strategy Map

- To show **how value is created** within the organization.
- To make it clear **how improvements in one area** (e.g., employee training) lead to success in another (e.g., financial performance).
- To help **employees understand** how their day-to-day work contributes to corporate strategy.

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2. Cause-and-Effect Flow (Top–Down Linkage)

The four perspectives are **linked hierarchically**, starting from the bottom:

Perspective	Role in the Strategy Map	Example Relationship
Organizational Capacity / Learning & Growth	Provides the foundation — develops people, systems, and culture.	Training employees and improving IT systems → Faster internal processes
Internal Process	Uses capabilities to improve operations and innovation.	Automation and process improvements → Quicker order turnaround

Perspective	Role in the Strategy Map	Example Relationship
Customer	Delivers improved value to customers.	Faster service and reliable quality → More customer satisfaction and loyalty
Financial	Achieves ultimate business outcomes.	More satisfied customers → Increased sales revenue and profitability

Flow Summary:
Learning & Growth → Internal Process → Customer → Financial

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3. Leading and Lagging Indicators

- **Non-financial measures** (Learning & Growth, Internal Process, Customer) are **leading indicators** — they predict future performance.
- **Financial measures** are **lagging indicators** — they show the results of past performance.

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4. Example: 3D Printing Company Strategy Map

Perspective	Strategic Objectives / Critical Success Factors
Financial	• Increase sales revenue by entering the online market. • Increase profitability by reducing variable costs.
Customer	• Increase number of customers through online marketing partnerships. • Increase sales volume by speeding up the quotation process.
Internal Process	• Improve order turnaround time by purchasing new, faster equipment.
Organizational Capacity / Learning & Growth	• Decrease order processing time by introducing an automated order system and training employees to use it.

Cause-and-Effect Chain:
Training & Automation (Learning & Growth) → Faster Order Processing (Internal Process) → Faster Quotes & More Customers (Customer) → Higher Sales & Profit (Financial)

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5. Key Takeaways

- A **strategy map links all perspectives** of the Balanced Scorecard in a logical, strategic sequence.
- It ensures **alignment** between operational actions and strategic financial goals.
- It converts abstract strategy into a **visual, easy-to-understand roadmap** for the entire organization.

Implementing a Balanced Scorecard (BSC)

1. Importance of Organization-Wide Support

Successful implementation of a **Balanced Scorecard** depends on:

- **Organization-wide awareness and commitment**.
- **Effective communication** of its purpose, structure, and benefits.

- **Strong leadership support** from top management and the **board of directors**.

The BSC must be presented as a system that links *actions → performance → strategy → long-term goals* through cause-and-effect relationships.

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2. Role of Top Management and the Board

- **Senior management** must **sponsor and champion** the program.
- The **board of directors** can have its own scorecard goals to reinforce strategic alignment and support from the top.
- Visible top-level commitment helps the program gain credibility across all levels of the organization.

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3. Involvement of Divisions and Business Units

- Each **business unit/division** develops its own **customized scorecard** based on corporate objectives.
- This builds **ownership and motivation** among managers and staff.
- **Senior management review** ensures that all divisional scorecards are **aligned** with the company's overall strategic goals.

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4. Structure of the Scorecard Report

A good BSC report should:

- Be organized by the **four perspectives**:
    1. Financial
    2. Customer
    3. Internal Process
    4. Organizational Capacity / Learning & Growth
- Include:
    - **Target values** (planned performance)
    - **Actual results** (achieved performance)
    - **Indicators** for variances (e.g., color-coded for favorable/unfavorable)
- Assign **responsibility**:
    - Each manager = accountable for specific performance lines.
    - Division head = accountable for the entire division's results.
- Identify **potential trade-offs**, such as:
    - Reducing R&D to boost short-term profits, which could hurt long-term performance.
    - Declines in R&D or quality metrics would act as early warning signals.

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5. Communication and Internal Marketing

The BSC must be **"marketed" internally** to build enthusiasm and participation.
Communication should occur through **print, verbal, and electronic channels**.

a) Print / Electronic Communication

- **Brochures and newsletters**: Explain benefits, share results, and celebrate success stories.
- **Intranet postings**: Display overall progress and link results to corporate goals.
- **Highlight both successes and challenges** to show transparency and accountability.

b) Verbal Communication

- **Regular meetings**: Management reviews scorecard results and invites employee feedback.
- **One-on-one discussions**: Supervisors engage employees closest to the work for practical insights.
- **Suggestion systems and training programs**: Encourage employee participation and improvement ideas.

Managers must **listen, respond, and reward** useful employee suggestions to maintain engagement and credibility.

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6. Technology and Accessibility

- Post **BSC results** on the company **intranet** with appropriate access levels:
    - General summaries for all employees.
    - **Detailed data** (via password) for senior managers' decision-making.

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7. Linking BSC to Compensation

- Tie **bonuses and incentives** to **goal achievement** under the Balanced Scorecard framework.
- Aligns employee behavior and motivation with strategic objectives.
- Reinforces the principle of **goal congruence** across all levels.

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8. Key Takeaways

Implementation Element	**Purpose / Benefit**
Top management support	Ensures credibility and commitment
Division involvement	Builds ownership and alignment
Clear reporting	Enables accountability and early detection of trade-offs
Continuous communication	Promotes understanding and motivation
Employee engagement	Encourages improvement and innovation
Technology integration	Improves visibility and accessibility
Incentive alignment	Strengthens goal congruence and performance focus

Balanced Scorecard Reporting – Summary

1. Purpose

Balanced scorecard reporting helps management monitor **both financial and non-financial performance measures**, linking daily operations to strategic goals.

Software can help track these metrics — but **software alone does not implement** a balanced scorecard. The company must first **develop its own scorecard**, implement it, and review results regularly.

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2. Example of a Balanced Scorecard Report

Perspective	Critical Success Factor	KPI (Measure)	Target	Result	Initiative	Interpretation
Financial	Increase sales revenue	Rate of sales growth	+20%	+25%	Enter international market	Target surpassed
	Increase profitability	Gross profit margin	45%	41%	Decrease variable costs	Slight improvement, below target
Customer	Increase number of customers	% increase in customers	+10%	+20%	Change marketing service	Target surpassed
	Increase sales volume	% increase in sales	+5%	+10%	Increase speed of quotes	Target surpassed
Internal Process	Improve turnaround time	Avg. picking/shipping time	–30 min	–35 min	Purchase new equipment	Target surpassed
Learning & Growth	Decrease order processing time	Avg. processing time	–20 min	–27 min	Automate order processing + training	Target surpassed

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3. Interpretation of Results

- **Financial:** Sales growth target exceeded; profitability slightly below goal.
- **Customer:** Significant increase in both customers and sales.
- **Internal Process:** Faster order fulfillment achieved.
- **Learning & Growth:** Automation and training improved processing time beyond target.

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4. Benefits

- Encourages **focus on long-term success**, not just short-term profits.
- Rewards managers for improving **key non-financial drivers** (like efficiency, training, or innovation).
- Strengthens the **link between strategy and action**.

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5. Limitations

- **Difficult to compare** across divisions (each has a unique scorecard).
- Requires **strong data systems (ERP)** to track diverse metrics.

- **Non-financial data** may lack audit reliability.
- **Weak cause-effect links** can cause failure (e.g., non-financial targets met, but profits don't rise).
- If used for control rather than learning, employees may **"game the numbers"** without true engagement.

✅ **Conclusion:**
When designed carefully and monitored continuously, the **Balanced Scorecard** provides a **comprehensive framework** for translating an organization's strategy into measurable actions and outcomes.

Customer and Product Profitability Analysis — Summary Notes

1. Purpose

To identify which **customers** and **products** are profitable and which are not — so the company can:

- Focus resources on profitable ones.
- Improve or drop unprofitable ones.

💡 **80–20 Rule (Pareto Principle):**

- 80% of profits come from 20% of customers.
- 20% of customers are often **unprofitable**.

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2. Customer Profitability Analysis (CPA)

Definition:

A process that measures the **profitability of individual customers or customer groups** by comparing **revenues earned** and **costs to serve**.

Uses:

- Identify **high-cost-to-serve** customers → reprice or reduce services.
- Identify **low-cost-to-serve** customers → offer discounts to increase sales.
- Strengthen relationships with **most profitable customers** through better service.
- **Targeted marketing:** focus marketing efforts on profitable customer segments.

Example: Bank Account Analysis

- Bank tracks each business customer's:
    - Average loan balances
    - Interest income
    - Cost of funds
    - Fees for services (cash management, lockbox, etc.)
- The **account analysis report**:
    - Calculates total service costs.
    - Gives a credit for deposits kept on account.

    - Determines the net fee to charge the customer.
- Customers can reduce fees by keeping higher non-interest-bearing deposits.

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3. Product Profitability Analysis (PPA)

Definition:

Determines which **products or services** are profitable and which are not.

Purpose:

- Identify unprofitable products → **re-price** or **discontinue**.
- Replace with **higher-margin** or **more popular** products.
- Use **Activity-Based Costing (ABC)** to accurately assign indirect costs.

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4. Importance of Accurate Cost Allocation

- Shared/common costs must be properly allocated.
- **ABC** helps assign costs based on actual resource use.
- Wrong allocations can make good customers/products look bad (or vice versa).

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5. Decision-Making: Relevant vs. Irrelevant Costs

Concept	Meaning	Relevance
Relevant Costs	Future costs that differ between alternatives	✅ Include
Irrelevant Costs	Costs that do not change between alternatives	❌ Exclude
Sunk Costs	Past costs that cannot be changed	❌ Irrelevant
Avoidable Costs	Costs that can be eliminated if activity stops	✅ Relevant
Unavoidable Costs	Costs that continue regardless of decision	❌ Irrelevant

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6. Examples

- **Avoidable Costs:** Direct labor, materials, variable overhead related to a specific product or customer.
- **Unavoidable Costs:** Factory rent, allocated admin salaries, depreciation on idle equipment with no alternative use.

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7. Key Decision Rule

Drop a customer or product **only if** the **avoidable costs exceed** the **lost revenue**.

If dropping them **saves less cost than the revenue lost**, keep them.

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8. Division-Level Decision

When evaluating whether to close an entire **division**, only include **relevant revenues and costs** — i.e., those that would change if the division closed.

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9. Managerial Focus

Managers must always ask:

"What difference will this decision make?"
"Which costs and revenues will change as a result?"

✅ **Summary Conclusion:**
Customer and Product Profitability Analysis helps businesses:

- **Focus on profitable segments**
- **Improve pricing and service strategies**
- **Make rational drop/keep decisions** based on **relevant and avoidable costs**, not arbitrary allocations or sunk costs.